No. 10202

In the United States Circuit Court of Appeals for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

STIMSON MILL COMPANY, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE PETITIONER

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OPINION BELOW

The opinion of the Board of Tax Appeals (R. 20–24) is reported at 46 B. T. A. 141.

JURISDICTION

On June 28, 1940, the Commissioner mailed to the taxpayer a notice of a deficiency of $380 in its income tax for the year 1938. (R. 8.) On August 19, 1940, taxpayer filed a petition with the Board of Tax Appeals for a redetermination of the deficiency pursuant to Section 272 of the Internal Revenue Code. R. 1, 3–7.) On January 27, 1942, the Board entered its decision, finding no deficiency in income tax for the year 1938. (R. 24.) The case is brought to this Court by the Commissioner's petition for review filed April 18, 1942 (R. 25–28) pursuant to Sections 1141 and 1142 of the Internal Revenue Code.

QUESTION PRESENTED

Section 112 (b) (6) of the Revenue Act of 1938 provides that in certain specified circumstances no gain or loss shall be recognized upon the receipt by a parent corporation of "property" distributed in complete liquidation of a subsidiary corporation. Does the word "property" include money?

STATUTE INVOLVED

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * *

(b) *Exchanges Solely in Kind.*—

* * * * *

(6) *Property received by corporation on complete liquidation of another.*—No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. For the purposes of this paragraph a distribution shall be considered to be in complete liquidation only if—

(A) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 per centum of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), and was at no time on or after the date of the adoption of the plan of liquidation and until the receipt of the prop-

erty the owner of a greater percentage of any class of stock than the percentage of such class owned at the time of the receipt of the property; and

(B) no distribution under the liquidation was made before the first day of the first taxable year of the corporation beginning after December 31, 1935; and either

(C) the distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year; in such case the adoption by the shareholders of the resolution under which is authorized the distribution of all the assets of such corporation in complete cancellation or redemption of all its stock, shall be considered an adoption of a plan of liquidation, even though no time for the completion of the transfer of the property is specified in such resolution; or

(D) such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock in accordance with a plant of liquidation under which the transfer of all the property under the liquidation is to be completed within three years from the close of the taxable year during which is made the first of the series of distributions under the plan, except that if such transfer is not completed within such period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

If such transfer of all the property does not occur within the taxable year the Commissioner

may require of the taxpayer such bond, or waiver of the statute of limitations on assesment and collection, or both, as he may deem necessary to insure, if the transfer of the property is not completed within such three-year period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, the assessment and collection of all income, war-profits, and excess-profits taxes then imposed by law for such taxable year or subsequent taxable years, to the extent attributable to property so received. A distribution otherwise constituting a distribution in complete liquidation within the meaning of this paragraph shall not be considered as not constituting such a distribution merely because it does not constitute a distribution or liquidation within the meaning of the corporate law under which the distribution is made; and for the purposes of this paragraph a transfer of property of such other corporation to the taxpayer shall not be considered as not constituting a distribution (or one of a series of distributions) in complete cancellation or redemption of all the stock of such other corporation, merely because the carrying out of the plan involves (i) the transfer under the plan to the taxpayer by such other corporation of property, not attributable to shares owned by the taxpayer, upon an exchange described in paragraph (4) of this subsection, and (ii) the complete cancellation or redemption under the plan, as a result of exchanges described in paragraph (3) of this subsection, of the shares not owned by the taxpayer.

* * * * *

STATEMENT

All of the facts were stipulated, and found by the Board as stipulated. (R. 13–16, 20.)

In 1930 taxpayer transferred cut-over timberland to Second Holding Corporation in exchange for all of the latter's stock. Second Holding Corporation was organized solely for the purpose of liquidating the land, and transferring the proceeds to taxpayer. Proceeds were distributed to taxpayer in each of the years 1931, 1932, 1937, and 1938. (R. 20–21.)

The 1938 distribution completed the liquidation of Second Holding Corporation and the corporation was thereupon abandoned. Taxpayer claimed a loss deduction of $2,000 (the maximum capital loss deduction permitted under Section 117 (d)). It was disallowed by the Commissioner on the theory that no loss could be recognized for tax purposes because of Section 112 (b) (6). (R. 20–21.) The Board of Tax Appeals held Section 112 (b) (6) inapplicable, interpreting the word "property" in that statute as excluding money; the receipts by taxpayer from Second Holding Corporation had been entirely in cash or its equivalent. (R. 22–24.) The Commissioner was appealed. (R. 25–28.)

STATEMENT OF POINTS TO BE URGED

The Board of Tax Appeals erred in deciding that Section 112 (b) (6) of the 1938 Act, which provides for the nonrecognition of gain or loss upon receipt by a parent corporation of "property" distributed in liquidation of a subsidiary corporation, refers to property other than money.

SUMMARY OF ARGUMENT

As ordinarily understood, the word "property" includes money. The Board member incorrectly reasoned that the word was intended to have a narrower meaning in Section 112 (b) (6) of the Revenue Act of 1938. As used in various contexts throughout the statute, the word may mean, broadly, all kinds of property, or, more narrowly, property other than money. Where the narrower meaning has been intended but was not clear from the context, Congress has expressly distinguished money. There is no such express limitation upon "property" as used in Section 112 (b) (6). Money obviously is included in "property" as the word is used in the adjoining Sections 112 (b) (5) and 112 (b) (7), which deal with situations generically similar to those covered by Section 112 (b) (6).

The legislative history of Section 112 (b) (6) makes it quite clear that it was intended to refer to money, among other kinds of property. Section 112 (b) (6) of the 1934 Act, as amended in 1935, expressly excluded money from the scope of the word "property." The excluding words were omitted in Section 112 (b) (6) of the 1936 law (which was re-enacted without change in 1938). At the same time, certain special provisions necessary to properly deal with a differentiation between money and other property, which had been contained in the earlier statute, were omitted from the 1936 statute (and the 1938 statute). Committee Reports with respect to related provisions of the 1938 law in referring to Section 112 (b) (6) state that the word

"property," as there used, includes money. Any other conclusion would lead to absurd results.

The Commissioner's position is supported by a consistent administrative practice (evidenced by a published ruling) followed in numerous cases where the revenue has thereby suffered, i. e., cases involving liquidating distributions resulting in gain. The application of Section 112 (b) (6) to such cases is much more frequent than it is to cases like that at bar involving loss.

ARGUMENT

Introductory

Section 112 (b) (6) of the Revenue Act of 1938, *supra,* provides that no gain or loss shall be recognized upon receipt by a corporation "of property distributed in complete liquidation of another corporation" where the recipient owns at least 80 per cent of the stock of the liquidating corporation, and certain other conditions are satisfied. The purpose of this provision, which appeared for the first time in its present form in the Revenue Act of 1936, was to encourage the simplification of corporate structures. See remarks on the floor of Congress concerning Section 112 (b) (6) of the Revenue Act of 1936 by Senator George (Cong. Record, Vol. 80, Part 8, p. 8799), and Congressman Doughton (Cong. Record, Vol. 80, Part 10, p. 10279); *Helvering* v. *Credit Alliance Corp.,* 316 U. S. 107, 112.

The instant case involves the application of this provision to the liquidation by the taxpayer, Stimson Mill

Company, of its wholly owned subsidiary corporation, Second Holding Corporation. The final liquidating distribution was received by taxpayer in 1938. This distribution, when added to the others previously received, came to less than the taxpayer's basis in the shares of Second Holding Corporation. Accordingly, in its return for 1938, taxpayer claimed a capital loss measured by the difference between its basis and the total of the liquidation distributions, but limited to $2,000. Revenue Act of 1938, Sections 115 (c) and 117 (d). The Commisisoner disallowed any deduction, claiming that no loss was to be recognized because of Section 112 (b) (6). The Board held Section 112 (b) (6) inapplicable because the distributions in the instant case were in cash or its equivalent. (R. 14.) The Board thought that "property" as used in Section 112 (b) (6) was not broad enough to include money. The decision was by a single member or division; it was not reviewed by the whole Board.[1]

The Commissioner believes that the Board member's interpretation was palpably erroneous, and consequently has filed a petition for review.

The word "property" in Section 112 (b) (6) of the 1938 Act includes money

The Supreme Court has observed that "the plain, obvious and rational meaning" of statutory words is always to be preferred to any curious or narrow meaning. *Old Colony R. Co.* v. *Commissioner,* 284 U. S. 552,

[1] The Commissioner's motion for review by the whole Board was denied.

560. Webster's International Dictionary (1933) defines property as—

> that to which a person has a legal title; * * * an estate, whether in lands, goods, money or intangible rights * * *.

Black's Law Dictionary (3rd ed.) says that "property" is commonly used to denote "everything which is the subject of ownership." As used in statutes other than the Revenue Acts, the word "property" is commonly interpreted to include money. See, e. g., Section 17 of the Bankruptcy Act (U. S. C. 1940 ed., Title 11, Sec. 35) as interpreted in *Bloemecke* v. *Applegate,* 271 Fed. 595, 600 (C. C. A. 3rd); *Hallagan* v. *Dowell,* 139 N. W. (Ia.) 883; *Griffin* v. *Bergeda,* 279 S. W. (Tenn.) 385.[2]

Therefore, "property" in Section 112 (b) (6) must be taken to include money unless some special legislative purpose to narrow its meaning can be drawn from the context, the surrounding statutory provisions, or the legislative history. The Board member adopted the premise that the surrounding statutory provisions exhibited a carefully segregated use of the word "property," on the one hand, and the word "money," on the

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[2] Conversely, money is frequently used as synonymous with property. *Salt Lake County* v. *Utah Copper Co.*, 93 F. 2d 127, 132 (C. C. A. 10th). To give the word "money" a narrow sense, and carve it out of "property" as a separate classification would lead to some uncertainty. It is not entirely clear whether "money" would refer purely to cash, or whether it would also include certain equivalents of cash, such as bank deposits, Treasury notes, etc. In a strict legal sense, bank deposits are choses in action and not distinguishable from other rights to collect money on demand, such as demand notes. Incidentally, it is a fair inference that the "money" in the instant case consisted of bank deposits. The record is not specific.

other; he concluded that consistency required the elimination of "money" from "property" in Section 112 (b) (6). (R. 22–23.) We shall demonstrate that both the premise and the conclusion were unsound.

An examination of the entire Revenue Act of 1938 will reveal that the word "property" is used sometimes in its broader sense, as including money, and sometimes in the narrower sense of property of a less liquid character. For instance, in Section 22 (b) (3), which excludes from gross income the value of "property" acquired by gift, bequest, devise, or inheritance, the word obviously has the broader meaning. Cf. Internal Revenue Code, Section 811, which was first enacted as Section 302 of the Revenue Act of 1926 (describing the value of a decedent's gross estate for estate tax purposes as equivalent to the value of "property" belonging to the decedent, or in which he may have certain specified interests).

On the other hand, Section 111 is concerned with measuring the gain or loss realized upon the liquidation of property. It is evident that money, which is the most liquid form of property, cannot be so disposed of as to result in gain or loss. Accordingly, "property" in Section 111 evidently does not refer to money. But this narrower use of the word in Section 111 is dictated by the context and certainly does not argue for a similarly narrow construction in some other context.

Coming specifically to Section 112 (b) we find that "property" is used in a number of subdivisions. In subdivisions (1) and (4) it apparently again has the

narrower meaning, because its context does not suggest any possible need for the broader. But in subdivisions (5), (6) and (7) the broader meaning is demanded.

Section 112 (b) (7), like Section 112 (b) (6), deals with corporate liquidations. The word "property" as there used manifestly includes money. The section provides that in the case of "property" distributed in complete liquidation, the recipient shareholder may, under certain circumstances, elect to have his gain taxed in a specified manner. Subdivisions (E) and (F) then proceed to describe the manner in which the gain from the property received is to be taxed, and in doing so, specially provide for that part of the property received which consists "of money" or of securities acquired after a stated date.

Section 112 (b) (5) immunizes from tax effect the transfer of "property" to a corporation solely in exchange for the corporation's stock, if the amounts of stock received by the transferors are proportionate to their former interests in the "property." It has been held by this Court that the word "property" in Section 112 (b) (5) does include money, so that if "A" transfers $100,000 in cash to a new corporation, "B" transfers $100,000 worth of other property to it, and each receives half of the stock, the proportionate interest requirement of Section 112 (b) (5) is met. *Halliburton* v. *Commissioner,* 78 F. 2d 265. Accord *Portland Oil Co.* v. *Commissioner,* 109 F. 2d 479, 488–489 (C. C. A. 1st); *Claude Neon Lights* v. *Commissioner,* 35 B. T. A. 424.[3] The Board member in

[3] This decision was made by the whole Board, three members dissenting.

the instant case recognized that Section 112 (b) (5), as thus construed, did not fit into his pattern, but dismissed the inconsistency with the remark that Section 112 (b) (5) had a special purpose which was served by that special construction. Singularly enough, the member overlooked a rather similar special purpose in Section 112 (b) (6).

In a sense Section 112 (b) (6) is the converse of Section 112 (b) (5). Section 112 (b) (5) is intended to exempt from tax effect the incorporation of privately owned assets under certain special circumstances. Section 112 (b) (6) is intended to exempt from tax effect the disincorporation of assets under special circumstances. In neither section can any sound reason be discerned for distinguishing between assets which happen to consist wholly or largely of cash and assets which include little or no cash. As this Court pointed out in the *Halliburton* case, most new corporations need at least some cash capital, and it is only logical to apply Section 112 (b) (5), even though the cash capital is contributed by some of the stockholders while the nonliquid capital is contributed by others (provided, of course, the value of the respective contributions is proportionate to the stock received). Similarly, where Section 112 (b) (6) is concerned, the elimination of a subsidiary corporation is as reasonably made tax free when its assets are liquid as when they are in a more frozen state. Either way, the simplification of corporate structures is accomplished in accordance with the statutory purpose. Either way, the tax-exempt gain is the same, that is, it is the difference between the parent's basis in the

subsidiary's stock and the total cash amount or value of the assets received.[4]

The Board member's interpretation of Section 112 (b) (6) stultifies itself by its own futility, since it suggests an obvious avoidance. The subsidiary need only invest its money in some readily salable asset, like high grade corporate bonds or Government securities. These can then be liquidated to the parent and immediately sold without gain or loss because the parent takes the subsidiary's basis under Section 113 (a) (15). Nor could such an expedient be characterized as an evasion to be disregarded for tax purposes; as pointed out, there is as much reason to encourage elimination of liquid subsidiaries as frozen ones; it could only be presumed

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[4] Cash in the subsidiary's hands represents either paid-in capital or the proceeds of property sales or other dealings. If it represents the former, it deserves to be taxed no more than less liquid capital. If it represents the latter, it has been taxed to the subsidiary.

The Board member seemed to think that his interpretation of the statute was necessary in order to prevent a simple means of tax evasion. He postulated the case where a taxpayer corporation buys property for $X, transfers it to a new corporation for the latter's stock, has the new corporation sell the property for $3X, and then liquidates the new corporation. The member concluded that the taxpayer should not be permitted to avoid tax on $2X gain by means of the Commissioner's interpretation of Section 112 (b) (6). (R. 22–23.) The answer is, of course, that the taxpayer would not avoid tax on the $2X gain in the supposed case, even if the Commissioner's construction were adopted. The subsidiary would pay tax upon gain measured by the parent's basis. Section 113 (a) (8). That tax would reduce the assets to be returned to the parent and, therefore, would come out of the parent's pocket.

that the device was in furtherance of the statutory purpose.

It is apparent, therefore, that subdivisions (5), (6) and (7) of Section 112 (b), closely related in position and subject matter, all use the word "property" as including money. Any narrower use of the word in those subdivisions would frustrate their obvious purpose, lead to absurd results, or contravene their express language.

Indeed, it would appear that wherever "property" has been used in a context permitting the broad meaning including money, it has been intended to have that meaning unless otherwise specifically restricted. *Portland Oil Co.* v. *Commissioner, supra,* pp. 488–489. The whole Board (contrary to the opinion of the member in the instant case) has noted this. *Claude Neon Lights* v. *Commissioner, supra,* p. 430. And it is strikingly exhibited in the legislative history of Section 112 (b) (6) itself, a legislative history which we believe conclusively demonstrates the error of the Board member's construction.

That history is as follows: The original Section 112 (b) (6), differing in many respects from the one involved here, was added to the Revenue Act of 1934 by Section 110 (a) of the Revenue Act of 1935. The original provision never became effective because it was scheduled to operate for the tax years beginning after December 31, 1935 (Revenue Act of 1935, Section 110 (e)), and it was superseded by Section 112 (b) (6) of the Revenue Act of 1936.

But this 1935 statute is significant in that it provided for the tax-free receipt by a corporation of "property (other than money)" from a liquidated subsidiary.[5]

The making of a distinction between property and money in a provision of this kind instantly leads to a special problem for distributions consisting partly of money and partly of other property (as most do). Normally, the recipient of a liquidating distribution is taxed upon gain measured by cash received, plus the value of other property received. If gain from the nonliquid portion of the receipts is to be exempted from tax, but gain from the liquid portion is to be taxed, then some sort of allocation is necessary. There are three obvious alternatives, viz, (1) the money may be first allocated to basis, leaving no taxable gain unless money alone exceeds basis; (2) the nonliquid receipts may be first allocated to basis, making taxable all gain up to the amount of cash received; or (3) the money and nonliquid receipts may be proportionately allocated to basis, making a pro rata part of the gain taxable.

A choice among these methods is not obvious without specific statutory guidance. Such guidance has been given for reorganizations, in connection with which only the receipt of securities is made tax free. See e. g., Revenue Act of 1938, Section 112 (b) (2), (3) and (4). Where the stockholder or participating corporation receives money or other property ("boot") as well as securities, it has long been customary to provide for the second method of calculating taxable gain. Section

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[5] The words "(other than money)" were finally inserted in place of the words "or money" which appeared in one of the earlier drafts of H. R. 8974.

112 (c) (1) of the Revenue Acts of 1938, 1936, 1934, 1932 and 1928; Section 203 (d) (1) of the Revenue Acts of 1926 and 1924. A similar problem is presented if loss, instead of gain, is involved, and for many years it has been provided that no deduction shall be allowed even though "boot" is received. Section 112 (e) of the Revenue Acts of 1938, 1936, 1934, 1932 and 1928; Section 203 (f) of the Revenue Acts of 1926 and 1924.

Section 110 of the 1935 Act recognized these problems in connection with the tax-free liquidation distribution of "property (other than money)" provided for in Section 112 (b) (6) of the 1934 Act, as added by its subsection (a). Accordingly, its subsections (b) and (c) inserted references to Section 112 (b) (6) in both Section 112 (c) (1) and Section 112 (e) of the 1934 Act. Thus the 1935 Act has made express provision for the method of taxation where the property distributed in complete liquidation consisted partly of money or "boot."

Section 112 (b) (6) of the 1936 Act uses the word "property" without the qualifying parenthetical phrase "(other than money)" which appeared in the 1935 provision. This omission is significant in itself. But it is even more significant that reference to Section 112 (b) (6) has been eliminated from Section 112 (c) (1) and Section 112 (e) of the 1936 Act. Thus, the provisions which were urgently needed to define the method of taxation, if money and other property were to be distinguished, were withdrawn from the Revenue Act of 1936. This clearly demonstrates that Congress did not intend to distinguish between money and other property in Section 112 (b) (6) of that Act.

Sections 112 (b) (6), 112 (c) (1) and 112 (e) are identical in the 1936 and 1938 Acts.

Furthermore, the Committee Report with respect to Section 115 (h) of the Revenue Act of 1938 (S. Rep. No. 1567, 75th Cong., 3rd Sess., pp. 18–19 (1939–1 Cum. Bull. (Part 2) 779, 792)) contains the following very significant statement:

> In view of the fact that sections 112 (b) (6) and (7) permit the distribution of property (including money), in addition to stock or securities, without the recognition of gain to the distributee, appropriate changes are made in section 115 (h) of the House bill in the interest of added clarity.

In view of the legislative history, the Congressional mandate is plain. "Property" obviously was used in Section 112 (b) (6) in its ordinary sense, so as to include liquid as well as nonliquid assets, and the narrow construction adopted by the Board member must be rejected. The Treasury Department consistently has adhered to the broader meaning in its practice. G. C. M. 19435, 1938–1 Cum. Bull. 176. A published ruling of the department charged with the administration of a law should be given persuasive force in interpreting the law. *White* v. *Winchester Club,* 315 U. S. 32. And the General Counsel's memorandum involved here deserves more than usual respect for the following reason. Section 112 (b) (6) obviously would encourage gainful liquidations and discourage liquidations resulting in loss. It is a fact that numerous Section 112 (b) (6) liquidations have involved gain and included considerable amounts of cash, while the cases like that at bar, exhibiting loss, have been very

few. Thus, the Bureau ruling has taken a position disadvantageous to the revenue, and to reverse it would adversely affect many more taxpayers than would be helped. Furthermore, it would hurt many of them in a particularly serious way, since they have been liquidated in reliance upon the broad construction of Section 112 (b) (6) and the liquidation cannot now be reversed. Hence, they would find themselves liable to heavy and unanticipated income tax, unless the statute of limitations upon additional assessments had run. Section 112 (b) (6) is a current provision (see Internal Revenue Code) and there would be many cases where the statute of limitations had not run.

In litigation involving the application of Section 112 (b) (6) to gainful liquidations, it has been assumed by the whole Board and the courts that the Treasury was correct in considering money to be "property." *Credit Alliance Corp.* v. *Commissioner,* 42 B. T. A. 1020, affirmed 122 F. 2d 361 (C. C. A. 4th), 316 U. S. 107; *Commissioner* v. *Kay Mfg. Corp.,* 122 F. 2d 443 (C. C. A. 2nd), certiorari denied May 4, 1942.

CONCLUSION

For the many reasons stated, the decision of the Board member was erroneous and should be reversed.

Respectfully submitted,

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